

THE OFFICE OF REGULATORY STAFF
DIRECT TESTIMONY & EXHIBIT
OF
DANIEL F. SULLIVAN
SEPTEMBER 24, 2018



DOCKET NO. 2017-370-E

Joint Application and Petition of South Carolina Electric & Gas Company and Dominion Energy, Incorporated for Review and Approval of a Proposed Business Combination between SCANA Corporation and Dominion Energy, Incorporated, as May be Required, and for a Prudency Determination Regarding the Abandonment of the V.C. Summer Units 2 and 3 Project and Associated Customer Benefits and Cost Recovery Plans

DIRECT TESTIMONY AND EXHIBIT OF

DANIEL F. SULLIVAN

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2017-370-E

**IN RE: JOINT APPLICATION AND PETITION OF SOUTH CAROLINA
ELECTRIC & GAS COMPANY AND DOMINION ENERGY,
INCORPORATED FOR REVIEW AND APPROVAL OF A PROPOSED
BUSINESS COMBINATION BETWEEN SCANA CORPORATION AND
DOMINION ENERGY, INCORPORATED, AS MAY BE REQUIRED, AND
FOR A PRUDENCY DETERMINATION REGARDING THE
ABANDONMENT OF THE V.C. SUMMER UNITS 2 & 3 PROJECT
AND ASSOCIATED CUSTOMER BENEFITS AND COST RECOVERY
PLANS**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Daniel F. Sullivan. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the South Carolina Office of Regulatory Staff (“ORS”) as the Deputy Director of the Audit Department.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration with a major in Accounting from the University of South Carolina in December 1998. From February 1999 to February 2005, I was employed as an auditor with the South Carolina Auditor’s Office. In that capacity, I performed audits and reviews of cost reports filed by institutional providers of Medicaid services for the South Carolina Department of Health and Human Services. The primary purpose of these audits and reviews was to establish the applicable

reimbursement rates to be paid to Medicaid providers for services rendered to qualified Medicaid patients. In February 2005, I began my employment with ORS and since then have participated in cases dealing with the regulation of telecommunications, gas, electric, radioactive waste disposal, water and wastewater utilities.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA (“COMMISSION”)?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to set forth the findings and recommendations resulting from ORS’s examination of the joint application and petition (“Application”) of South Carolina Electric & Gas Company and Dominion Energy, Incorporated (“SCE&G”, “Dominion”, or the “Companies”) in Docket No. 2017-370-E and SCE&G’s September 30, 2017 Quarterly Report (“Quarterly Report”). These findings and recommendations are explained in detail in my testimony.

Q. PLEASE DESCRIBE THE PROCEDURES USED TO PERFORM THE EXAMINATION.

A. The ORS Audit Department’s examination consisted of two major steps. In step one, ORS verified the per books operating experience and rate base, reported by SCE&G in its Quarterly Report and that the Application for the various cost recovery plans, were supported by the accounting books and records for the twelve months ended September 30, 2017. In the second step, ORS verified the accounting and pro forma adjustments proposed by SCE&G as part of the various cost recovery plans were calculated correctly, noting any errors.

Q. DID THE ORS AUDIT DEPARTMENT'S EXAMINATION FOCUS PRIMARILY ON ONE PARTICULAR COST RECOVERY PLAN?

A. Yes. The ORS Audit Department's examination was primarily focused on the Customer Benefit Plan ("CBP"). ORS recommends significant changes to the CBP and various conditions such that the merger does not harm customers.

Q. PLEASE EXPLAIN THE RELATIONSHIP BETWEEN THE PER BOOKS AMOUNTS REPORTED IN SCE&G'S QUARTERLY REPORT AND THE PER BOOKS CBP FINANCIALS FILED IN THE APPLICATION.

A. The per book amounts reported in SCE&G's Quarterly Report agree to the per book retail allocated financials filed in the Application under the CBP with the exception of the per books customer growth amount.

Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN THE PER BOOKS CUSTOMER GROWTH AMOUNT REPORTED ON SCE&G'S QUARTERLY REPORT AND THE PER BOOKS CUSTOMER GROWTH AMOUNT REPORTED IN THE APPLICATION UNDER THE CBP.

A. During the discovery process, ORS inquired about the calculation of the per books customer growth amount shown on Exhibit 14 of the Application. SCE&G's response noted an error in the calculation of the per books customer growth amount for the CBP. The \$3,329,938 shown on Exhibit 14 of the Application was calculated using a retail operating return of \$687,878,663 which did not include the tax impact of the annualized interest adjustment. SCE&G provided an updated calculation of the per books customer growth using the correct retail operating return of \$703,984,209 which results in the

customer growth calculation of \$3,407,903. This agrees with the customer growth calculation as reflected on the Quarterly Report attached as Audit Exhibit DFS-1.

Q. ARE THERE ANY OTHER DIFFERENCES BETWEEN THE INFORMATION REPORTED ON SCE&G'S QUARTERLY REPORT AND THE FINANCIALS FILED IN THE APPLICATION?

A. Yes.

Q. PLEASE EXPLAIN THOSE DIFFERENCES.

A. First, the Quarterly Report only depicts retail electric operations while the Application depicts both total electric operations and retail electric operations. Second, the Quarterly Report depicts the base retail electric operations excluding the impact of New Nuclear Development ("NND") on revenues, expenses, and rate base. The financials in the Application include the impacts of NND based on the Companies' various proposed cost recovery plans.

Q. DID ORS IDENTIFY ANY CALCULATION ERRORS DURING THE VERIFICATION OF THE ACCOUNTING AND PRO FORMA ADJUSTMENTS PROPOSED BY SCE&G AS PART OF THE VARIOUS COST RECOVERY PLANS?

A. Yes. ORS found one calculation error associated with SCE&G Adjustment #8. The allocation of the 12 month amortization of existing software to electric operations was not calculated correctly resulting in an immaterial change to the adjustment amount.

Q. PLEASE DESCRIBE THE REASONING BEHIND ATTACHING SCE&G'S QUARTERLY REPORT AS AN EXHIBIT.

1 **A.** As stated above, the Quarterly Report depicts its operating experience, rate base
2 and rate of return for retail electric operations based on the twelve months ended September
3 30, 2017 excluding the impacts of NND. This exhibit shows that as of September 30, 2017
4 SCE&G earned a Return on Equity (“ROE”) of 8.39% without recovery of any
5 abandonment costs. ORS believes that attaching the Quarterly Report as an exhibit will
6 serve as a basis for the Commission when reviewing and interpreting the results of ORS’s
7 analyses and recommendations which are outlined in the direct testimony of ORS witness
8 Lane Kollen.

9 **Q. ARE THE NET INCOME FOR RETURN, RATE OF RETURN, AND RETURN ON**
10 **EQUITY SHOWN ON AUDIT EXHIBIT DFS-1 AND EXHIBIT 14 OF THE**
11 **APPLICATION AN ACCURATE REPRESENTATION OF SCE&G’S CURRENT**
12 **ELECTRIC OPERATION’S EARNINGS?**

13 **A.** No. There have been many changes to SCE&G’s revenues, expenses and rate base
14 since September 30, 2017. For example, based on the Company’s March 31, 2018
15 Quarterly Monitoring Report, salaries, benefits and pension expense had decreased since
16 September 30, 2017. Also, since September 30, 2017 the Federal Tax Cuts and Jobs Act
17 legislation was passed. This reduced the federal tax rate from 35% to 21% and will reduce
18 the federal taxes SCE&G will incur in 2018 and into the future. In addition, other expenses
19 and rate base items will have increased or decreased based on activity, need, inflation or
20 market prices since September 30, 2017. Therefore, the income for return, rate of return,
21 and return on equity figures shown on Audit Exhibit DFS-1 and Exhibit 14 of the
22 Application are not reflective of the Company’s current operating experience.

Q. WHAT IS THE STATUS OF THE SOUTH CAROLINA DEPARTMENT OF REVENUE (“DOR”) SALES AND USE TAX ASSESSMENT ON V.C. SUMMER UNITS 2 AND 3?

A. Due to the abandonment, SCE&G has recently been assessed sales and use tax on V.C. Summer Units 2 and 3 by the DOR. SCE&G has appealed the assessment and the total sales and use tax to be paid by SCE&G is not known or measurable.

Q. IF SCE&G RESOLVES THE SALES AND USE TAX ISSUE WITH THE DOR AND PAYS A SETTLED UPON AMOUNT, SHOULD THE COMMISSION ALLOW SCE&G RECOVERY OF THE EXPENSE?

A. No. Company witness Kevin Kochems states in his direct testimony that SCE&G made the decision to absorb as expenses any costs incurred on the project after the close of the third quarter of 2017. Accordingly, there are no costs associated with activities conducted after September 30, 2017 included in the Applicants proposal of prudently incurred capital costs.¹ ORS recommends the Commission require SCE&G to absorb and not recover from ratepayers, any sales and use taxes paid as a result of DOR’s assessment as well as any other possible pending NND related costs as these costs will have been incurred after September 30, 2017.

Q. SCE&G WITNESS IRIS GRIFFIN USES THE TWELVE MONTHS ENDED DECEMBER 31, 2017 AS THE BASIS FOR HER ANALYSIS OF THE FINANCIAL RESULTS THAT WOULD BE ACHIEVED UNDER EACH OF THE APPLICANTS’ PROPOSED COST RECOVERY PLANS. DID ORS PERFORM A REVIEW FOR THIS TIME PERIOD AS WELL?

¹ Reference pg. 11 lines 13-18, 21-22 and pg. 12 lines 1-4 of Company witness Kevin Kochems’ direct testimony.

1 A. No. ORS performed its review based on the test period proposed by the Applicants
2 in the Application, the twelve months ended September 30, 2017.

3 **Q. DO YOU AGREE WITH SCE&G WITNESS GRIFFIN'S ASSERTION THAT HER**
4 **EXHIBITS (ING-1, ING-2, ING-3, AND ING-4) ARE NOT AN ACCURATE**
5 **REPRESENTATION OF SCE&G'S CURRENT ELECTRIC OPERATIONS?**

6 A. Yes. Witness Griffin states that the resulting returns on rate base shown on her
7 exhibits overstate the actual returns that would be earned on the capital invested in
8 SCE&G's electric utility business because the impairments that SCE&G has recorded or
9 would record, under generally accepted accounting principles for financial accounting
10 purposes reduce rate base without any change in income. The same income earned on a
11 smaller rate base results in the calculation of a higher ROE. Therefore, returns computed
12 net of these impairments are inflated because they are returns based only on the portion of
13 the capital investors who have invested in SCE&G's electric utility system. SCE&G has
14 computed the returns under each of the regulatory plans that reflect earnings on an impaired
15 capital investment under those plans but does not adjust the capital structure to reflect the
16 amounts written off for accounting purposes through impairments.²

17 **Q. ARE THERE ANY OTHER REASONS WHY THE EXHIBITS (ING-1, ING-2, ING-**
18 **3, AND ING-4) IN WITNESS GRIFFIN'S TESTIMONY ARE NOT AN**
19 **ACCURATE REPRESENTATION OF SCE&G'S CURRENT ELECTRIC**
20 **OPERATIONS?**

21 A. In addition to the reason outlined in witness Griffin's testimony, the analyses do
22 not accurately represent SCE&G's current electric operations for the same reasons

² Reference pg. 36 lines 11-15, pg. 37 lines 1-6, and pg. 38 lines 17-20 of Company witness Iris Griffin's direct testimony.

mentioned above regarding SCE&G's September 30, 2017 Quarterly Report. There have been many changes to SCE&G's revenues, expenses and rate base since December 31, 2017.

Q. DO THE PER BOOKS AMOUNTS REPORTED IN WITNESS GRIFFIN'S EXHIBITS AS OF DECEMBER 31, 2017 AGREE TO THE AMOUNTS REPORTED IN THE SCE&G DECEMBER 31, 2017 QUARTERLY REPORT?

A. No. The December 31, 2017 Quarterly Report does not account for any of the impacts resulting from the impairments SCE&G has recorded. As discussed previously, witness Griffin's exhibits take into account some of the effects of the impairments.

Q. WERE THERE DIFFERENCES IN THE EXAMINATION PERFORMED BY THE ORS AUDIT DEPARTMENT AS PART OF THIS DOCKET VERSUS AN EXAMINATION PERFORMED FOR A TRADITIONAL APPLICATION FOR A RATE INCREASE?

A. Yes. This docket sought approval for a business combination between SCANA Corporation and Dominion and a prudency determination regarding the abandonment of the V.C. Summer Units 2 and 3 project and associated cost recovery plans. ORS did not perform a traditional rate increase examination of SCE&G's books and records as the Companies did not seek an increase in base rates in this docket.

The ORS Audit Department in this docket performed a limited review of SCE&G's twelve months ended September 30, 2017 per books figures reported on the Quarterly Report and the various cost recovery plans schedules. ORS also performed a limited review of accounting and pro forma adjustments to ensure they were calculated and stated correctly. For a traditional application for a rate increase, ORS would perform analytical

reviews of accounts, sample and test underlying transactions on the general ledger, identify and remove non-allowable expenses for rate making purposes, and verify compliance with prior Commission orders to ensure expenses and rate base items were stated correctly.

Q. HOW MUCH HAS SCE&G'S NON-NEW NUCLEAR DEVELOPMENT RETAIL ELECTRIC GROSS PLANT IN SERVICE INCREASED SINCE THEIR LAST BASE RATE CASE?

A. SCE&G's adjusted retail electric gross plant in service in Docket No. 2012-218-E was approximately \$8,375,022,000. The Quarterly Report indicates retail electric gross plant in service of \$9,637,535,966. Therefore, SCE&G's non-new nuclear development retail gross plant in service has increased by approximately \$1,262,513,966 since their last base rate case. This additional gross plant in service has not been considered in the determination of SCE&G's current non-nuclear development base rates as SCE&G has not filed a base rate case since 2012.

Q. WILL YOU UPDATE YOUR TESTIMONY BASED ON INFORMATION THAT BECOMES AVAILABLE?

A. Yes. ORS fully reserves the right to revise its recommendations via supplemental testimony should new information become available not previously provided by the Companies, or from pending state and federal investigations and lawsuits.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

**SOUTH CAROLINA ELECTRIC & GAS COMPANY
RETAIL ELECTRIC
OPERATING EXPERIENCE
TWELVE MONTHS ENDED SEPTEMBER 30, 2017**

EXHIBIT A

<u>DESCRIPTION</u>	<u>PER BOOKS ADJ. FOR REGULATORY ORDERS</u> (\$)	<u>ACCOUNTING & PRO FORMA ADJUSTMENTS</u> (\$)	<u>TOTAL AS ADJUSTED</u> (\$)
	COL. A	COL. B	COL. C
<u>OPERATING REVENUES</u>	<u>2,573,825,310</u>	<u>(452,787,901)</u>	<u>2,121,037,409</u>
<u>OPERATING EXPENSES</u>			
Fuel Costs	623,287,164	-	623,287,164
Other O&M Expenses	583,711,611	4,392,040	588,103,651
Deprec. & Amort. Expenses	267,744,349	2,490,706	270,235,055
Taxes Other Than Income	206,069,444	3,912,165	209,981,609
Income Taxes	<u>189,028,533</u>	<u>(124,043,294)</u>	<u>64,985,239</u>
Total Operating Expenses	1,869,841,101	(113,248,383)	1,756,592,718
Operating Return	703,984,209	(339,539,518)	364,444,691
Customer Growth	3,407,903	(1,643,670)	1,764,233
Int. on Customer Deposits	<u>(1,114,066)</u>	<u>-</u>	<u>(1,114,066)</u>
Total Income for Return	<u>706,278,046</u>	<u>(341,183,188)</u>	<u>365,094,858</u>
<u>ORIGINAL COST RATE BASE</u>			
Gross Plant in Service	9,642,974,430	(5,438,464)	9,637,535,966
Reserve for Deprec.	<u>3,777,308,466</u>	<u>664,854</u>	<u>3,777,973,320</u>
Net Plant	5,865,665,964	(6,103,318)	5,859,562,646
CWIP	4,885,050,807	(4,682,396,997)	202,653,810
Net Deferred/Credits	9,547,089	18,928	9,566,017
Accum. Def. Income Taxes	(1,144,013,449)	(296,866,643)	(1,440,880,092)
Materials & Supplies	422,196,596	14,274,571	436,471,167
Working Capital	<u>17,474,474</u>	<u>549,005</u>	<u>18,023,479</u>
Total Original Cost Rate Base	<u>10,055,921,481</u>	<u>(4,970,524,454)</u>	<u>5,085,397,027</u>
RATE OF RETURN	7.02%		7.18%
RETURN ON EQUITY	8.09%		8.39%

Note: For information purposes only, including DSM revenues and expenses, the Total as Adjusted ROE is 8.97%